No. 87-267

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

D.H. HOLMES CO., LTD.,
Appellant,
v.

SHIRLEY MCNAMARA, SECRETARY OF REVENUE AND TAXATION, THE DEPARTMENT OF REVENUE AND TAXATION, STATE OF LOUISIANA,
Appellee.

On Appeal from the Court of Appeal, Fourth Circuit, State of Louisiana

BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT

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QUESTION PRESENTED

Whether a state's imposition of a use tax on a retailer on its merchandise catalogs distributed via the United States mail from outside the taxing State directly to residents within the taxing State contravenes the Commerce Clause of Article I, Section 8, Clause 3 of the Constitution of the United States?

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* in support of the Appellant in the above-captioned case. Written consents of the Appellant and the Appellee have been obtained and are attached herewith.

INTEREST OF AMICUS CURIAE

The Council of State Chambers of Commerce (COUNCIL), organized in 1932, consists of 42 Chambers of Commerce. The Committee on State Taxation (COST), one of the three advisory committees of the COUNCIL, consists of 262 corporate members which conduct a substantial portion of the interstate commerce of United States taxpayers. One of COST's principal activities has been to work with the States and others toward developing fair and equitable standards of state taxation.

Member companies of COST are representative of that part of the Nation's business sector which is most directly affected by state taxation of interstate operations. COST is, therefore, vitally interested in cases such as this one which present issues significantly affecting state and local taxation of interstate commerce.

This case involves an important constitutional question: Whether levy of Louisiana use tax on a Louisiana merchant's cost of purchasing catalogs outside Louisiana and having them mailed from out-of-state locations directly to mailboxes of selected Louisiana residents, without charge, constitutes an impermissible burden on interstate commerce. The Louisiana Court of Appeal, Fourth Circuit, held that imposition of use tax does not infringe the Commerce Clause.

Merchants and other businesses have long utilized the interstate postal system to disseminate catalogs and other printed advertising and informational materials. Prior to the Louisiana Court of Appeal decision in *D.H. Holmes Co., Ltd. v. McNamara*, 505 So. 2d 102 (1987), state courts consistently accorded such interstate mailings immunity from use tax under the long-established rule prohibiting taxation of tangible personal property while in the stream of interstate commerce. For example, in *District of Columbia v. W. Bell & Co., Inc.*, 420 A.2d 1208 (D.C. App. 1980), a case involving facts virtually

identical to those here but affirmed on statutory grounds, the appellate court nevertheless reiterated the constitutional principles articulated below:

> "[S]ince the catalogs were placed in the stream of interstate commerce outside of the District and came to rest only when they reached the individuals to whom they were addressed, the Commerce Clause of the United States Constitution, Art. I, § 8, Cl. 3, prohibits the state from taxing such goods to Bell." 420 A. 2d at 1210.

The court cited *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), and *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954), in observing that it is well established that property may not be taxed while moving in interstate commerce. *Id.*

Affirmation of the Louisiana court's ruling will have adverse consequences for all types of business. In addition to catalogs and other printed advertising disseminated by merchants, virtually every kind of business, large and small, utilizes the U.S. Mail to send printed advertising or informational materials without charge to selected consumers. A substantial portion of such mailings are in interstate commerce. Thus, the Louisiana court's unprecedented holding that a use tax can be validly levied on the cost of catalogs by virtue of their "distribution" through the interstate postal system to Louisiana addressees will detrimentally affect the free flow of catalogs and other printed materials mailed in interstate commerce. The novel principle adopted by the Louisiana court—i.e., property mailed from outside the State=in-state distribution=taxable use—could be applied by any State with an appropriately-worded statute to any kind of interstate mailing of advertising or informational material by a firm having a presence in the State. For example, under the ruling, use tax could be applied to the cost of interstate mailings of annual re-

ports to shareholders of companies having an in-state presence.

Companies affected by the *Holmes* ruling will not only be liable for additional taxes but also the inevitable spread of this concept to other States will prove at least as administratively burdensome as the "welter of complicated obligations to local jurisdictions" that this Court in *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753, 760 (1967), feared would impede the free conduct of interstate business if mail order firms were required to collect tax on interstate mail order sales to customers in States where the firm is not physically present. The Court noted:

> "The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements." 386 U.S. at 760.

The "complicated obligations" and "local entanglements" alluded to by the Court concerned the burden associated with requiring non-nexus mail order firms to collect taxes from customers at varying state and local rates on interstate sales. In contrast with the *duty to collect tax* on interstate sales of merchandise involved in *National Bellas Hess*, Holmes is confronted with the *imposition of a direct tax liability* measured by the cost of the catalogs.[1] Thus, Holmes and others having direct tax liability under this holding will be required to deal not only with variations in state and local tax rates but also with detailed record-keeping of printing costs, quantities mailed and their destination, in order to comply with the

[1] It should be noted that this is *not* a *National Bellas Hess* situation wherein the issue was whether a mail order firm (1) sending potential customers its catalogs, (2) receiving orders from customers, and (3) shipping goods to customers in interstate commerce, is required to collect use tax on those goods. In this case, the question is whether the mailing of the catalog itself (whether or not an order is placed) requires a use tax to be paid on the cost of the catalogs to the State where the customer resides.

variations in the tax bases upon which States levy their use taxes. For example, a company's "cost" of printed materials subject to use tax may be limited in one State to tangible property costs, such as paper and ink, while another State may also require inclusion of intangible items, such as production costs and a third state may require mailing costs to be included as well.

In every instance prior to *Holmes*, where an aggressive state taxing authority sought to apply its use tax to the cost of materials mailed from out-of-state locations to residents of the State, state courts have consistently ruled in favor of the taxpayer challenging the state's authority to impose such tax.

For example, the Tennessee Supreme Court, applying Tennessee's use tax statute which is virtually identical to Louisiana, ruled that the Commerce Clause prohibited the imposition of use tax on a Tennessee merchant with regard to catalogs and other advertising material shipped via common carrier and the U.S. Mail from an out-of-state printer to residents of Tennessee. *Service Merchandise Co. v. Tidwell*, 529 S.W. 2d 215 (Tenn. 1975). Similarly, in *District of Columbia v. W. Bell & Co., Inc.*, 420 A. 2d at 1210, the court noted the repugnance to the Commerce Clause of the District's assessment of use tax on catalogs which came to rest when they reached preselected addresses in the District, following an uninterrupted journey in interstate commerce. Also, the Wisconsin Circuit Court for Dane County granted taxpayers' motion for summary judgment and held that catalogs mailed to Wisconsin addressees from outside the State cannot be subjected to Wisconsin use tax because: 1) there was no taxable use of the catalogs in Wisconsin by the taxpayers; and 2) there was a lack of substantial nexus between the State and the mailed catalogs, which nexus was not satisfied by the presence in Wisconsin of taxpayers' stores. *J. C. Penney Company, Inc. v. Wis-*

consin Department of Revenue, No. 84-CV-3978 (Wis. Cir. Ct. 1985) (unpublished).*

The principle in this area has long been clear. Use tax assessments on interstate mailings of catalogs and other promotional material are improper because the merchant has no taxable use of the property received by residents of the State. *See, Modern Merchandising, Inc. v. South Dakota Department of Revenue*, 397 N.W. 2d 470 (S.D. 1986); *Wisconsin Department of Revenue v. J. C. Penney Company, Inc.* 323 N.W. 2d 168 (Wis. App. 1982); *Sears, Roebuck & Co. v. Washington Department of Revenue* 643 P.2d 884 (Wash. 1982) (State did not appeal trial court holding in favor of Sears that catalogs shipped directly by out-of-state printers to Washington addressees were not "used" by Sears within the meaning of the Washington statute); *Sears, Roebuck & Co. v. Ohio Tax Commissioner*, 436 N.E. 2d 1020 (Ohio 1982); *Hoffman-La Roche, Inc. v. Porterfield*, 243 N.E. 2d 72 (Ohio 1968); *Bennett Brothers, Inc. v. New York State Tax Commission*, 405 N.Y.S.2d 803, 62 A.D.2d 614 (N.Y. 1978); *Mart Realty, Inc. v. Norberg*, 303 A. 2d 361 (R.I. 1973); *J. C. Penney Company, Inc. v. Illinois Department of Revenue*, No. 75 L 16730 (Ill. Cir. Ct. 1977) (unpublished).*

Thus, the *Holmes* decision is contrary to the holdings of every other state court on this issue. In upholding the use tax assessment against Holmes' Commerce Clause challenge, the Louisiana Court of Appeal disregarded longstanding precedent and misapplied the constitutional standards established by this Court. The decision should be reversed.

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* This opinion has been lodged with the Court.

SUMMARY OF ARGUMENT

A State may not, consistent with the Commerce Clause, assess its use tax against a merchant on its cost of catalogs printed out-of-state and mailed in interstate commerce directly to residents of the taxing State, free of charge.

ARGUMENT

THE LOUISIANA TAX VIOLATES THE COMMERCE CLAUSE BECAUSE IT IS IMPOSED ON AN ACTIVITY WITH WHICH THE STATE LACKS "SUBSTANTIAL NEXUS."

In upholding imposition of tax against Holmes' Commerce Clause challenge, the Louisiana Court of Appeal analyzed the application of the tax in light of *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), and *Washington Department of Revenue v. Association of Washington Stevedoring Companies*, 435 U.S. 734 (1978), and found that the application of the tax did not violate the Commerce Clause. Under the four-part test established in *Complete Auto Transit*, a tax statute does not violate the Commerce Clause if the tax: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does discriminate against interstate commerce; and (4) is fairly related to services provided by the State.[2]

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[2] *Complete Auto Transit* and *Association of Washington Stevedoring Companies* decided only that taxes on the "privilege of engaging in interstate commerce" were valid if they satisfied the four-part test. In both cases, the income sought to be taxed was generated by activities performed entirely within the State. A subsequent decision of the Court, *Commonwealth Edison Company v. Montana*, 453 U.S. 609 (1981), applied the four-part test and upheld imposition of Montana severance tax similarly measured by activities performed entirely within the State, namely, in-state mining activity prior to entry of the coal in interstate commerce.

This Court has yet to decide how, or whether, the four-part test applies to a Commerce Clause challenge to a use tax or other tax imposed on property moving in interstate commerce. On the Louisiana use tax levy against Holmes, the result is the same under either analysis. The tax is contrary to the court's long-established jurisprudence forbidding state taxation of goods in interstate commerce. Similarly, the tax cannot be sustained under the *Complete Auto Transit* analysis because Louisiana does not have "substantial nexus" with the activity it seeks to tax, the distribution of catalogs in interstate commerce.

The Louisiana Court of Appeal applied the four-part test to imposition of use tax on Holmes' catalogs and concluded that the tax satisfied each part. In finding that the tax satisfied the first, or "substantial nexus", test, the court said:

> "The nexus requirement is met because Holmes operates 13 stores intrastate. It has approximately 5,000 Louisiana employees, 500,000 charge customers, and 1,500,000 customers within the state. 82% of the total number of catalogs were mailed into Louisiana and 1,000 were distributed from the Canal Street store." 505 So. 2d at 105.

The Louisiana Court of Appeal erred in finding that the imposition of tax upon Holmes satisfied the "threshold" or "substantial nexus" requirement. Such finding is wrong because it is premised on the misconception that the "substantial nexus" test was satisfied by virtue of the presence in Louisiana of Holmes' stores.

The "substantial nexus" requirement means that the State imposing the tax must have a significant connection with the specific activity being taxed. *Complete Auto Transit v. Brady*, 430 U.S. at 279. It is *not* enough that Louisiana have nexus with Holmes; it must have nexus with Holmes' activity of distributing catalogs. Holmes

acknowledges that it is present in Louisiana and has nexus there for many purposes (and accordingly pays Louisiana property, income, franchise, sales and use taxes, including Louisiana taxes applicable to merchandise sales generated by the catalogs). However, Louisiana does not have a substantial nexus with the "activity" involved in this appeal, namely, the distribution of the catalogs, and, therefore, under the cases construing the Commerce Clause, Louisiana cannot tax that activity.

The activity upon which Louisiana imposed tax was the "distribution" by Holmes of catalogs to Louisiana addressees. The pertinent provision is La. Rev. Stat. § 47:302(A)(2), which provides, in relevant part, as follows:

* * * *

> "A. There is hereby levied a tax upon . . . the distribution . . . of each item or article of tangible personal property, . . . the levy of said tax to be as follows:
>
> (2) At the rate of [a given percentage] of the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed or stored for use or consumption in this state. . . ."

The Louisiana Court of Appeal found that Holmes "used" the catalogs within the meaning of the statute and stated that:

> "Distribution of the catalogs certainly constitutes 'use' by Holmes under the statute and is subject to tax." 505 So. 2d at 105.

The Louisiana court also found that:

> "After the catalogs were in Louisiana mailboxes they were not part of interstate commerce and became part of the property mass in the state." *Id.*

That finding satisfied the statutory intent that the Louisiana use tax law may not be applied to property

while in interstate commerce as expressed in La. Rev. Stat. § 47:305(E), which declares, in relevant part:

> "(E) It is not the intention of this Chapter . . . to levy a tax on bona fide interstate commerce. It is, however, the intention of this Chapter to levy a tax on . . . the distribution . . . of tangible personal property after it has become a part of the mass of property in this state."

The uncontroverted facts do not support the Louisiana court's findings that the distribution of the catalogs constituted a "use" by Holmes. All acts and activities relating to the distribution of the catalogs occurred outside Louisiana or while the catalogs were in the stream of interstate commerce. Therefore, Louisiana lacked "substantial nexus" with the activity—i.e., distribution—on which the tax was imposed.

The catalogs were designed in New York and printed in Oklahoma City, Boston or Atlanta. The finished catalogs were delivered by the printer to local offices of the United States Postal Service, postage prepaid, for direct mailing to pre-selected residents of Louisiana. Other than the small portion of catalogs mailed to its New Orleans store for distribution to customers, which Holmes conceded are taxable because they are used by Holmes in Louisiana, at no time did Holmes, its employees, or its agents receive or take possession of the catalogs mailed from out-of-state post offices. Once the catalogs were placed in the mail by the out-of-state printer, they entered the stream of interstate commerce and remained there until their ultimate delivery to Louisiana addressees.

Upon delivery, the Louiisana recipients had unrestricted ownership and possession of the catalogs and were free to use or discard them at their pleasure. Thus, if there were a taxable use of the catalogs—presumably, many of them are discarded and not used at all—such use would be by the recipients of the catalogs, not by Holmes.

Accordingly, the Louisiana court's finding that the catalogs ceased to be in interstate commerce after they were delivered to Louisiana mailboxes is irrelevant to its finding that "distribution" constitutes a "use" by Holmes.

In effect, Louisiana predicated its tax upon "use" by Holmes while the catalogs were in uninterrupted interstate commerce, before they came to rest and attained a tax situs in Louisiana. This is inconsistent with the manner in which a use tax has traditionally been applied to property brought into a State; that is, taxation has been restricted to use after the property leaves the stream of interstate commerce and comes to rest within the State. This Court's observation in *Henneford v. Silas Mason*, 300 U.S. 577 (1937), the first decision of the Court upholding a general use tax over objections that it violated the Commerce Clause, is instructive on this point:

> "The tax is not upon the operations of interstate commerce, but upon the privilege of use after commerce is at an end." 300 U.S. at 582.

The Court has consistently held that, once interstate movement has begun, property in transit remains immune from state taxation until the property comes to rest within the state, *see, e.g., Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157 (1954); *J. Bacon & Sons v. Martin*, 305 U.S. 380 (1939); *Pacific Telephone & Telegraph Co. v. Gallagher*, 306 U.S. 182 (1939); or, unless a break in the transit occurs in the taxing State that is not incidental to or necessary to further the interstate movement, *see, e.g., Minnesota v. Blasius*, 290 U.S. 1 (1933).

These holdings are relevant to the analysis to determine whether a challenged tax satisfies the "substantial nexus" requirement of the four-part test established in *Complete Auto Transit*. Because property lacks a tax situs while in the stream of interstate commerce, a use tax can be validly applied only to an act or activity with

respect to the property occurring after the interstate commerce is completed (or before it begins). *Minnesota v. Blasius*, 290 U.S. 1 (1933). In the instant case, because the activity Louisiana is seeking to tax—i.e., Holmes' distribution of the catalogs—occurred entirely outside the State and while the catalogs were in interstate commerce, the requisite "substantial nexus" with the activity is lacking. The Louisiana Court of Appeal, therefore, erred in finding there was "substantial nexus."

Compare the Louisiana court's Commerce Clause analysis with the Arkansas Supreme Court's analysis in *Martin v. Riverside Furniture Corp.*, 730 S.W. 2d 483 (Ark. 1987). In that case, the taxpayer raised a Commerce Clause objection to imposing use tax upon printed advertising materials shipped from an out-of-state printer to the taxpayer's Arkansas office where the taxpayer collated, packaged and remailed the materials to sales representatives located outside Arkansas. The taxpayer asserted that taxation of these materials was precluded by a provision in the Arkansas use tax law virtually identical to the Louisiana statute in the instant case. The Arkansas court described the Commerce Clause considerations reflected in the provision as follows:

> "The last sentence of the statute recognizes the constitutional limitation of a state's imposition of a tax on goods in interstate transit. If the goods have not "come to rest" within the state, they are still in the stream of interstate commerce, and a tax may not be levied. . . ." 730 S.W. 2d at 485.

In rejecting the taxpayer's objection to the tax as an impermissible burden upon interstate commerce, the court concluded that because the advertising materials came to rest within the State, albeit for a short period for the purpose of packaging, addressing and mailing, they were not a part of interstate commerce and, therefore, use tax may properly be imposed.[3] The Iowa Supreme Court

[3] The Arkansas court made the following observation regarding *Complete Auto Transit*: "We take this opportunity to recognize that *Brady* does not address that question of whether an item's transit through interstate commerce is continuous or sufficiently interrupted so as to come to rest" 730 S.W. 2d at 485-6.

reached the same result on virtually identical facts in *Inter-State Nurseries, Inc. v. Iowa Department of Revenue*, 164 N.W. 2d 858 (Iowa 1969). *See also Deere & Co. v. Allphin*, 364 N.E. 2d 117 (Ill. App. 1977), where use tax was upheld based on the processing of advertising materials by taxpayer's agent in Illinois prior to their delivery to the post office for interstate mailing

The facts in *Holmes* differ from these cases in the significant respect that after the catalogs came to rest in Louisiana upon being deposited in the mailboxes of Louisiana recipients, the catalogs were the property of the recipients and any use of the catalogs was by the recipients, not by Holmes. Thus, the Louisiana tax was imposed on "use" by Holmes while the catalogs were in interstate commerce and, necessarily, at a point when Louisiana did not have "substantial nexus" with the catalogs or their distribution by Holmes.

In finding "substantial nexus" based on the presence of Holmes' stores in Louisiana, the Louisiana Court of Appeal evidently confused the "substantial nexus" which must be present in order to sustain imposition of a direct tax against a Commerce Clause challenge with the nexus required to impose a duty to collect tax from a customer on an interstate sale of merchandise. This Court's decision in *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977) discusses the nexus required to impose a duty on the seller to collect tax on an interstate sale. In upholding California's right to require National Geographic to collect tax on its mail order sales to California residents, this Court said advertising offices maintained in California, even though unrelated to its mail order activity, constitute sufficient nexus to impose a tax collection duty upon National Geo-

graphic.[4] Citing *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954), the Court stated that:

> "the relevant constitutional test to establish the requisite nexus for requiring an out-of-state seller to collect and pay the use tax is not whether the duty to collect the use tax relates to the seller's activities carried on within the state, but simply whether the facts demonstrate "some definite link, some minimum connection, between [the State and] the *person* . . . it seeks to tax." 430 U.S. at 561.

While the court in *National Geographic* held that any nexus between the State and the person is sufficient to require an out-of-state seller to collect tax. *Complete Auto Transit* imposes a much more stringent nexus requirement to support imposition of a direct tax against a taxpayer. The requisite nexus, expressed by the Court in *Complete Auto Transit* in unambiguous terms, and recently reiterated in *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 107 S.Ct 2810 (1987), is that a tax can be sustained against a Commerce Clause challenge when the tax is applied to an activity having substantial nexus with the taxing state.

The record is clear that there was no in-state use of the catalogs by Holmes to support imposition of tax. All activities relating to the preparation and distribution of the catalogs, *e.g.*, design, printing, labeling, sorting, mailing, etc., occurred outside the territorial boundaries of Louisiana. From the time the catalogs were placed in the mail outside the State of Louisiana, they remained in

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[4] It should be noted that the Louisiana assessment herein involved a direct tax against Holmes on its cost of catalogs sent, free of charge, to Louisiana residents. In contrast, the issue in *National Geographic* was not whether National Geographic was liable for use tax on the cost of catalogs mailed to California residents, but whether California could require National Geographic to *collect* use tax on catalog merchandise ordered by California residents.

uninterrupted interstate commerce until they were delivered to Louisiana addressees. Thus, Louisiana lacked the requisite connection with the distribution of the catalogs, the activity upon which the tax was imposed, and, therefore, the Louisiana Court of Appeal erred in finding that "substantial nexus" was present to sustain the tax against Holmes' Commerce Clause challenge.

CONCLUSION

For the foregoing reasons, the imposition of use tax upon Holmes impermissibly burdens interstate commerce and, therefore, the Court should reverse the decision below.

Respectfully submitted,

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